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SUBJECT: TURKISH ECONOMY: PM GUL ANNOUNCES SOME FISCAL SAVINGS MEASURES - A GOOD FIRST STEP

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¶11. (SBU) Summary: The GOT reacted to the market concerns over the 2003 budget by agreeing on a list of fiscal saving measures, which PM Gul announced late afternoon January 8. Following the announcement, T-bill rates dropped half a percentage point. The "saving measures" are a mix of expenditure cuts and revenue increases that at face value amount to TL 6.225 quadrillion or 1.75 percent of projected 2003 GNP. Assuming IMF calculations that the GOT's first quarter budget presents a 2 percent of GNP primary surplus, then these measures, again if taken at face value, represent slightly less than half of the measures needed to achieve the 6.5 percent primary surplus target. PM Gul came close to announcing January 8 that 6.5 percent is the GOT's target. Treasury Deputy U/S Karaoz told us, after an all-night GOT meeting to adopt these measures, that Gul is "determined" to push through measures needed to reach this target. End Summary.

Market Wake-Up Call

¶12. (U) Concerns in the Turkish financial markets, focused on the 2003 budget, led to weak demand in the January 7 T-bill auctions (reftel), and continued in the secondary T-bill market on January 8.

-- T-bill yields reached 59.5 percent in compounded terms during January 8 trading (from yesterday's close of 58 percent). But following PM Gul's late afternoon announcement of fiscal saving measures (see below), bill rates declined half a percentage point. Opening quotes for tomorrow trading are 58.7 percent.

-- The stock market rose 4 percent January 8 (2 percent came after Gul's announcement).

-- The lira depreciated slightly, closing at TL 1,682,000 to the dollar (versus yesterday's TL 1,677,000).

¶13. (SBU) Comment: Thin trading volumes make single-day movements in the financial markets here not very meaningful (though the bill market had a relatively giant day - over \$1 billion in transactions.) One relatively large trade by a "big player" can move the entire market that day. For instance, two weeks ago when the Central Bank intervened to slow lira depreciation in the foreign exchange market - they were able to do so by selling only \$9 million in foreign exchange. However, the month-long trend which should continue to worry the GOT is the steady rise of T-bill rates, now up 11 percentage points since early December. The good news is the GOT is worried, and beginning to react, see below. End Comment.

PM Gul Announces Fiscal Saving Measures

¶14. (SBU) PM Gul emerged from a cabinet meeting in late afternoon of January 8 and made a televised announcement of a series of fiscal savings measures. (The list of measures was handed out at the press conference and is translated at para 7 below.) The bottom line is that through these measures the GOT projects 2003 budgetary savings of TL 6.225 quadrillion

(about \$3.8 billion), divided into TL 2.505 of spending cuts and TL 3.720 of revenue increases.

15. (U) Gul told the press:

-- Nobody should have any hesitation about our economic policy...Fiscal discipline is important. We all know that fiscal discipline was distorted before the elections.

-- The Finance Ministry is preparing the full-year 2003 budget and the GOT will submit the budget in the coming month.

-- "We will secure a 6.5 percent primary surplus in the future. The primary surplus is particularly important for Turkey's debt dynamics."

16. (U) A summary of the saving measures follow:

Expenditure Cuts: Total of TL 2.505 quadrillion.

- Personnel. Limit total new hires to 35,000 (such as teachers, health workers, police), TL 60 trillion.
- Health. Deduct pharmaceutical co-payments from civil servant wages; introduce prescription controls to prevent abuses, total of TL 316 trillion.
- Public Investment. Stop all new vehicle procurement. TL 90 trillion.
- "Transfer Budget" (central budget funds that go to state economic enterprises, extra-budgetary funds and social security funds). Stop all vehicle maintenance expenditures, introduce prescription controls on social security funds' pharmaceutical prescriptions, total of TL 559 trillion.
- Extra-budgetary Funds. The separate tax and fee revenues that used to go to these funds own administrative budgets will be given to the central government budget, TL 1 quadrillion. (Comment: One of the largest remaining extra-budgetary funds is the Military Industry Support Fund, the main military procurement agency, which has its own revenues from cigarette and alcohol taxes).

Revenue Increases: Total of TL 3.720 quadrillion.

- Restructuring of Delinquent Tax Claims Through the "Tax Peace" Law, total new revenue of TL 2.4 quadrillion.
(Comment: This law will restructure some 180,000 outstanding tax disputes, but we should be skeptical of the claim that it will net this amount of tax collection.) - 20 percent increase in the "Special Consumption Tax" (mainly tobacco and alcohol), TL 1.250 quadrillion.
- Raising rents on public housing, TL 70 trillion.

Comment: Good First Step, But Less than Halfway There

17. (SBU) How important are the saving measures announced today to the 2003 primary surplus target of 6.5 percent? If we take the measures at face value (and some analysts like Bender Securities have already told us the savings are exaggerated), then we calculate as follows:

-- Assuming the 2003 growth target of 5 percent and inflation target of 20 percent are achieved, then 2003 GNP will be about TL 355 quadrillion. The face value of savings is TL 6.225 quadrillion.

-- This represents 1.75 percent of GNP.

-- Assuming IMF calculations that the first quarter budget is at 2 percent of GNP, meaning a 4 percent of GNP shortfall in the primary surplus, then these saving measures represent less than half of the measures needed to reach the 6.5 percent target.

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